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Near East–South Asia: Regional Interdependence Spreads Misfortunes of Soft Oil Market

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A Research Paper

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Near East–South Asia: Regional Interdependence Spreads Misfortunes of Soft Oil Market [redacted] 25X1

A Research Paper

This paper was prepared by [redacted] Office of Near Eastern and South Asian Analysis. It was coordinated with the Directorate of Operations. Comments and queries are welcome and may be directed to the Chief, South Asia Division, NESA, [redacted] 25X1 25X1

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Near East–South Asia: Regional Interdependence Spreads Misfortunes of Soft Oil Market

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Key Judgments

Information available as of 2 August 1983 was used in this report.

A soft or further declining oil market that persists beyond the middle of the 1980s would have serious economic effects for the governments of the Near Eastern and South Asian countries and pose difficult policy choices for the United States:

- Key US allies such as Egypt and Pakistan, which would feel the pinch of reduced cash remittances from a cutback in their labor forces in the Gulf and of reduced aid from the Arab oil-exporting states, would almost certainly increase their requests for US aid. Morocco, another important US friend in the region, would also look to the United States to replace economic assistance slashed by the Arab oil exporters.

- Leaders of key oil-exporting and oil-importing countries, who will face growing domestic political opposition because of their increasing economic problems, would be less inclined to incur additional liabilities by supporting controversial initiatives proposed by the United States.

- The outlook for US exports of arms and other merchandise to the Near East and South Asia would be clouded. 25X1

Among the OPEC oil-exporting states of the region, Libya stands to suffer the most from a prolonged soft oil market. Because it has already made sharp spending cuts to bring government income and spending into balance, another cut in oil revenues could further reduce the availability of food and consumer goods and heighten discontent among the Libyan population with Qadhafi's policies. Because the other OPEC countries (except Iran and Iraq) have accumulated substantial financial reserves, they have avoided major spending cuts that affect consumer welfare—and the alienation of their citizenry—by drawing down financial reserves, delaying or canceling large new capital projects, and slowing import growth. A prolonged soft market or outright price collapse, however, would force the OPEC governments to cut spending on their own citizens, thereby increasing the risk of domestic political discontent. 25X1

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Among the non-OPEC oil exporters, Egypt will be the biggest loser economically and politically if the soft oil market persists because its economy is tied so inextricably to oil—revenues from its own production as well as indirect earnings from workers in the Gulf states, Suez Canal tolls, and Sumed pipeline fees. Unpopular austerity measures imposed in Egypt to counter the revenue losses would almost certainly increase domestic political opposition. Because the other non-OPEC oil exporters (Syria, Tunisia, Bahrain, and Oman) are already producing near capacity, they too face reduced oil revenues. [redacted] 25X1

Despite the savings gained by lower prices for their oil imports over the next year or two, capital-poor countries of the region face economic reversals from lost revenues if the soft oil market continues beyond that time frame:

- Cash remittances from migrant workers will decline as development is slowed in the oil-exporting states and the number of foreign workers cut back. Pakistan, Egypt, and North Yemen, where remittances from overseas workers form particularly large portions of the foreign exchange earnings, will be the biggest losers.

- Arab financial aid will be cut. The donor states are most likely to cut aid to the non-Arab states and least likely to slash aid to the Arab confrontation states and Iraq. [redacted] 25X1

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Scope Note

The countries of the Near Eastern–South Asian region have longstanding political, economic, and cultural ties. The large inflow of revenue to the oil producers that resulted from the oil price increases in the 1970s strengthened these linkages by stimulating regional aid programs and creating a large market for migrant workers. This paper surveys the economic changes that are now taking place in the region as a result of a softer oil market and suggests some potential political consequences of the changes. The paper is designed primarily to provide a regionwide overview and does not attempt an in-depth analysis of individual countries or OPEC.

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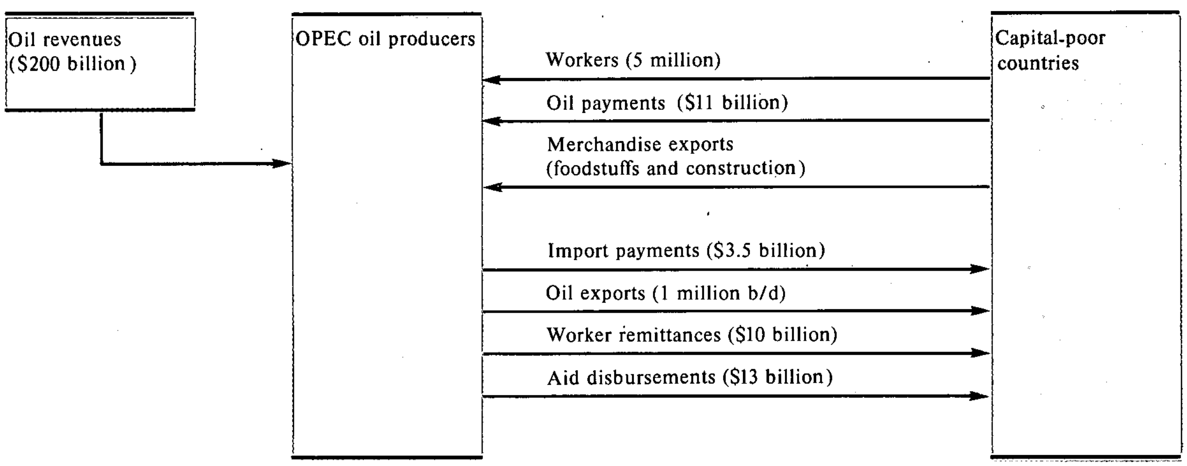
Figure 1
Near East-South Asia: Regional Economic Interdependence



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Near East–South Asia: Regional Interdependence Spreads Misfortunes of Soft Oil Market

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Regional Interdependence and the Oil Market

The interdependence of the countries in the Near Eastern–South Asian region will cause all of the countries in the region to suffer economic damage from a prolonged soft oil market (Figure 1 and foldout). The large inflow of revenues to the oil producers following the oil price increases of the 1970s strengthened political, economic, and cultural ties that had long existed among the countries of the region. The heightened interdependence also increased the vulnerability of the capital-poor states to the consequences of economic downturns among the oil producers:

- Accelerated development programs in the major oil-exporting countries utilized manpower that was surplus in most of the other countries of the region. Eighty-five percent of all workers were recruited from within the region.
- Cash remittances from these workers have increased in importance for economic development and balance-of-payments support for the capital-poor states.
- Several of the same capital-poor states have become the chief recipients of economic and/or military aid from the countries with surplus oil revenues, as more than 95 percent of all Arab aid has been confined to the Near Eastern–South Asian region.
- Pakistan and Morocco reap financial benefits from assignment of military forces for training and combat support to Saudi Arabia, the UAE, Kuwait, and Qatar.

Revenue Losses Force Oil Exporters To Tighten Belts

Cuts in prices and sales of oil will pose economic and financial constraints and a difficult period of adjustment for most of the oil exporters of the region.

Major Near Eastern and South Asian Countries, by Category

OPEC Oil Exporters:

Algeria	*Libya*
Iran	*Qatar*
Iraq	*Saudi Arabia*
Kuwait	*UAE*

Non-OPEC Oil Producers:

Bahrain	*Syria* *
Egypt *	*Tunisia* *
Oman	

Oil Importers:

Afghanistan *	*Morocco* *
Bangladesh *	*Nepal* *
India *	*North Yemen* *
Israel	*Pakistan* *
Jordan *	*South Yemen* *
Lebanon *	*Sri Lanka* *
Mauritania *	*Sudan* *

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* *Designates capital-poor state.*

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Revenues in 1982 of approximately $163 billion were more than $60 billion below peak revenues in 1980. Based on industry and US Government estimates of demand for oil from the Organization of Petroleum Exporting Countries (OPEC), we expect income to decline by an additional $25-50 billion this year (table 1).

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Anatomy of the Soft Oil Market

High oil prices, the worldwide recession, conservation, and fuel substitution have all contributed to a soft international oil market since early 1981. Oil production in the countries that are members of OPEC has fallen sharply since 1979 and thus far this year is averaging about 50 percent of the peak output of 31 million b/d in 1976. The average selling prices of all OPEC crudes also have declined from their peak in the first quarter of 1981. The oil ministers from the OPEC countries met in London in March 1983 and, in an unprecedented move, lowered the official price of their crude oil by $5 to $29 per barrel. New production quotas for the individual countries also were established. [redacted]

Recent gains in OPEC oil production and a firming in spot oil prices have signaled a return to more stable conditions in the oil market. The willingness of producers to cooperate and prospects for economic recovery should, in our view, cause prices to hold at current levels through December. In the absence of a sustained economic recovery and a rebound in oil use, the willingness of financially pressed producers to cooperate and hold the line on prices is likely to wane. Price weakness could reappear in early 1984 if OPEC expands production too rapidly and overshoots demand later this year. [redacted]

OPEC: The Big Money Losers

Most of the OPEC oil producers have already begun to make adjustments to cope with lower incomes. [redacted] some payments to foreign contractors have been put on hold, and new investment for oil facilities and other capital projects has been slowed or halted. Several of the Gulf states also have trimmed and tightened new employment opportunities for expatriate laborers, cut domestic subsidies on petroleum products, and are considering cuts in social programs. We expect the major Arab oil exporters to take a harder look at aid requests but believe that they will be discouraged from making sizable cuts because their security and their influence abroad rests heavily on cash transfers. The impact on military spending has been mixed. According to the Defense Minister and other Saudi officials, the military is committed to stepped-up purchases of equipment. On the other hand, UAE officials have reported to US Embassy officials that the high cost of military equipment and maintenance combined with lower oil revenues is likely to slow future purchases. [redacted] 25X1

While there has been some belt tightening, and more is to come, we believe that most of the OPEC oil producers can weather the effects of the oil price cuts because they have not spent all of their income from the boom years of the 1970s. Combined foreign official assets at the end of 1982 were about $300 billion (table 2). We expect all of the OPEC states to draw on foreign reserves to ease the transition to less 25X1
rapid economic growth and to forestall political and social unrest. An oil price collapse, however, would force more painful spending decisions, including reductions in benefits to their populations. We believe that, among the OPEC states, the governments of Libya and Iraq are least likely to meet domestic expectations because their financial reserves are already limited and they have been least able or willing to give consumer welfare a high priority [redacted] 25X1

We believe that a further deterioration in economic conditions in Libya or in the other OPEC states could set the stage for political instability. Additional cut- 25X1
backs in the availability of basic goods in Libya, for example, could increase popular discontent with the regime. If the soft oil market persists beyond two or three years, we believe that cuts in domestic spending could even foster internal discontent and assist Iranian recruitment of dissident Shias in politically stable countries such as Saudi Arabia and Kuwait. We believe reduced spending on foreign aid could result in 25X1
retaliation from aid recipients in the form of support 25X1
for terrorist activities in the major donor countries of Saudi Arabia, Kuwait, and the UAE. [redacted] 25X1

Table 1
Near Eastern and South Asian Oil Producers: Production and Revenue

	Oil Production [a] (*thousand b/d*)			Oil Earnings [b] (*billion US $*)		
	1980	1981	1982	1980	1981	1982
Total	**21,955**	**18,410**	**15,330**	**224.8**	**206.3**	**163.1**
OPEC	20,760	17,160	14,020	217.5	197.8	154.2
Algeria	1,020	805	700	14.9	12.2	10.7
Iran	1,660	1,380	2,280	12.9	11.3	18.7
Iraq	2,515	995	970	25.1	10.6	9.4
Kuwait [c]	1,660	1,130	820	18.5	13.3	8.4
Libya	1,830	1.135	1,185	22.8	15.2	13.7
Qatar	470	405	330	5.4	5.5	4.2
Saudi Arabia [c]	9,905	9,810	6,485	99.2	110.7	74.3
UAE	1,700	1,500	1,250	18.7	19.0	14.8
Non-OPEC	1,195	1,250	1,310	7.3	8.5	8.9
Bahrain	50	45	45	1.2	1.2	1.2
Egypt	595	600	665	2.5	2.8	2.9
Oman	280	320	320	2.4	3.3	3.1
Syria	160	165	160	0.6	0.6	1.1
Tunisia	110	120	120	0.6	0.6	0.6

[a] Does not include natural gas liquids. Based on industry and US Embassy reporting from producing countries. Data rounded to nearest 5,000 b/d.
[b] CIA estimate. Includes revenue from exports of crude oil, products, and natural gas liquids.
[c] Includes one-half production from the Neutral Zone.

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Non-OPEC Oil Producers: Price Adjustments Cushion the Shock

The non-OPEC oil producers, while also suffering from lower prices for their oil, are taking only small revenue cuts because they have more flexibility in adjusting selling prices. In most cases, they have maintained or even increased production to compensate for lower per-barrel revenue. Output in Egypt and Oman, for example, has reached record levels as they have undercut the terms adhered to by OPEC countries. The non-OPEC states cannot, however, count on growing oil revenues to alleviate tight foreign exchange situations and stimulate economic development because most are already producing near capacity. If the Gulf OPEC members object to their markets being taken by smaller producers and start a price war, we believe that the non-OPEC producers would stand little chance of maintaining their revenues. 25X1

Among the non-OPEC producers, we believe that Egypt and Bahrain face the greatest political threat from lower oil earnings. In Egypt, we believe that austerity measures enacted to cope with financial shortfalls could cause political problems for President Mubarak. In Bahrain, we expect the economic slowdown to exacerbate the government's problems in dealing with a large and often restless Shia population. 25X1

Table 2
Near Eastern and South Asian Oil Producers: Current Account Balance and Assets, 1982 [a]

Billion US $

	Current Account Balance	Official Foreign Assets Yearend [b]
OPEC		
Algeria	−2.5	5.0
Iran	6.1	13.0
Iraq	−18.8	5.0
Kuwait	6.8	70.0
Libya	1.2	9.5
Qatar	2.9	16.0
Saudi Arabia	14.9	155.0
UAE	3.9	36.0
Non-OPEC		
Bahrain	−0.1	1.6
Egypt	−2.4	1.7
Oman	0.8	1.5
Syria	−4.3	0.2
Tunisia	−0.6	0.7

[a] CIA Estimates and International Financial Statistics.
[b] Includes gold valued at $457 per ounce.

Table 3
Near Eastern and South Asian Oil Importers—Oil Imports, 1981

	Net Oil Imports (*thousand b/d*)	Net Oil Import Bill (*million US $*)	Savings [a] in 1983 (*million US $*)
Total	**980**	**12,955**	**1,695**
Middle East and North Africa	410	5,055	750
Israel	160	2,050	310
Jordan	40	540	75
Lebanon	60	700	105
Mauritania	5	65	10
Morocco	95	1,070	160
North Yemen	15	170	25
South Yemen	10	115	10
Sudan	25	345	55
South Asia	570	7,900	945
Afghanistan	10	175	25
Bangladesh	35	460	70
India	400	5,600	600
Pakistan	95	1,260	190
Sri Lanka	30	405	60

[a] Assumes imports maintained at the 1981 level and a 15-percent cut in oil prices except for India, where increased domestic production has allowed for a reduction in oil imports.

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The Capital-Poor States: Mixed Results of the Soft Oil Market

Economic Benefits: Lowered Import Bills

The countries in the region that are net oil importers have received immediate benefits from lowered oil import bills. We expect that this year the OPEC price of $29 per barrel, combined with interim cuts in spot and unofficial prices, will cut about $2 billion off the combined 1981 bill of nearly $13 billion (table 3). 25X1

India, which has accounted for 40 percent of regional imports and of the combined import bill, will be the biggest winner. If oil prices remain stable, India will save about $600 million in 1983—roughly equivalent to 17 percent of its projected current account deficit (table 4). Jordan and Bangladesh, which have been hit hard by their oil import bills, also will benefit from lower oil prices. Jordan's oil bill has been roughly three-fourths of its exports. Even though Bangladesh has one of the lowest levels of energy consumption in

Table 4
Oil Importers: Current Account Balance

Million US $

	FY 1979	FY 1980	FY 1981	FY 1982
Israel	−1,318	−743	−698	−1,900
Jordan	−1,065	−935	−1,316	−1,500
Morocco	−1,565	−1,469	−1,893	−2,057
Sudan	−455	−529	−773	−811
Bangladesh	−806	−1,472	−1,397	−1,440
India	−250	−2,940	−3,845	−3,500
Pakistan	−1,126	−1,145	−991	−1,424
Sri Lanka	−413	−805	−654	−868

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the world, roughly two-thirds of which is provided by indigenous noncommercial sources, its oil bill has been more than 60 percent of its total merchandise export earnings. [redacted]

Economic Drawbacks

Job Prospects in the Middle East Threatened. We believe that the diminished market for jobs that will result from a slowdown in economic development in the major oil-exporting countries poses the greatest potential danger for the capital-poor states. According to US Embassy reporting and scholarly studies, approximately 5 million Near Eastern and South Asian expatriate laborers currently work in the oil-exporting states—more than 80 percent of the total expatriate work force there. They remit more than $10 billion annually to their home countries which is significant in meeting their hard currency needs. [redacted]

We expect that if oil prices remain depressed, the rate of South Asian worker recruitment and their remittances will slow or even fall in absolute terms. Officials in three Gulf countries—the UAE, Qatar, and Iraq—have already reported a net reduction in the number of expatriate workers. According to US Embassy reporting, however, labor-importing countries overall have not reduced the size of their expatriate labor forces. [1] [redacted]

The number of South Asian workers in the nine major labor-importing countries in the Near East has increased fivefold since 1975 when the oil exporters began increasing their imports of non-Arab labor, according to researchers at the International Labor Organization and the World Bank (figure 2). The rapid growth in numbers of South Asian workers has been paralleled by a dramatic growth in their remittances (figure 3). Although oil prices started falling over a year ago, government data show a continuation of the upward trend in the number of migrant workers and the amount of remittances since then. Despite the growth, US Embassy officials report that South Asian governments are worried that the downturn in economic activity in the oil-rich states will eventually be reflected in a slowed, or even declining, rate of South Asian worker recruitment and a commensurate drop in their remittances. [redacted]

A leveling off or decline in remittances from workers in the major oil-exporting countries will have important implications for hard currency earnings in South Asia. On the basis of official government statistics, we 25X1 estimate that remittances from the Near East totaled $3-3.5 billion last year and constituted 60 to 70 percent of total South Asian worker remittances. We believe that Pakistan, which has supplied nearly three-fourths (1.5 million, 5 percent of its labor force) of the South Asian workers to the oil-exporting states, has the most to lose if a persistent soft oil market begins to limit jobs. India (600,000 to 700,000 workers, 0.2 percent of its work force), Sri Lanka (70,000, 1 percent of its work force), and Bangladesh (150,000, 0.3 percent of its work force) would be less affected. [redacted] 25X1

We also expect the soft oil market to contribute to the 25X1 leveling off or even a decline in absolute numbers of expatriate Arab workers. Based on a sampling of official data from the sending countries, we believe the number of expatriate Arab workers peaked in the late 1970s. If there is a further drop in oil prices and a large expulsion of foreign workers, however, we would expect the Arab laborers to fare better than the Asians. As Arabic speakers and the first group hired in the region, they stand a better chance of maintaining their jobs. In addition, the host governments 25X1 would face political pressure from other Arab states if Arab "brothers" were sent home before Asians. [redacted]

A review of the balance-of-payments accounts for the 25X1 past several years shows that, for most Arab sending countries, remittances have also leveled off or declined. They remain, however, a key element in the balance of payments for many of the capital-poor states such as North Yemen, Egypt, and Jordan [redacted] 25X1

Cutbacks in Arab Aid? While we do not expect a dramatic cutback in Arab aid to any of the recipient countries unless depressed oil prices persist beyond another year or two, some cutbacks already have been made and more are expected. Preliminary evidence

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[1] The nine labor-importing countries are Kuwait, Bahrain, UAE, Qatar, Oman, Saudi Arabia, Iraq, Libya, and Iran. [redacted]

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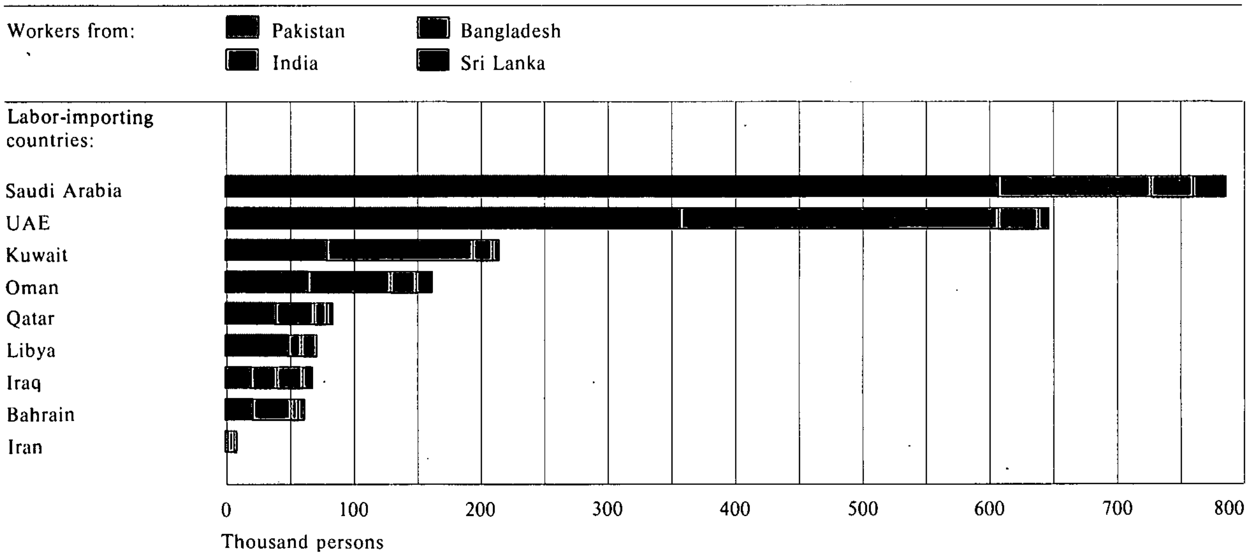
Figure 2
South Asian Labor in the Middle East, 1982[a]



[a] Estimated.

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indicates that economic assistance is being hit harder than military assistance. Some of the aid, especially from Saudi Arabia, is now being paid in the form of oil rather than money.

The Gulf Arab oil exporters have paid out an average of $13 billion annually in bilateral aid, about 99 percent of total OPEC aid (table 5). Of the Arab aid disbursements, 90 percent goes to fellow Arab states. Saudi Arabia normally spends $7-8 billion annually on such aid, Kuwait and the UAE most of the rest. Iraq was the next-largest donor prior to the outbreak of the war with Iran, when oil exports were reduced and aid funds diverted to fight the war. Libya, while frequently associated with financing radical causes, has not been especially generous with economic aid.

In our view, if the major Arab oil exporters find that additional cuts in aid disbursements are necessary for domestic reasons, they will cut the states least vital to their security—first the countries outside the Near East and South Asia, next India and Bangladesh, and finally Pakistan and Morocco. We believe that support to the Arab confrontation states and to Iraq would continue relatively unscathed. We expect, however, that aid payments from some of the states may not be as timely as they were in the past.

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Energy Self-Sufficiency Retarded. If the soft oil market persists past the middle of the decade, we expect it to limit the number of new oil discoveries in countries striving to attain energy self-sufficiency such as India and Pakistan. The worldwide surplus of oil productive capacity, the reduced exploration budgets of the major international oil companies, and the questionable creditworthiness of many countries are already hindering efforts by oil-importing countries to explore for domestic reserves.

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India's last solicitation of bids for petroleum exploration and production-sharing rights generated almost no interest from foreign companies already faced with

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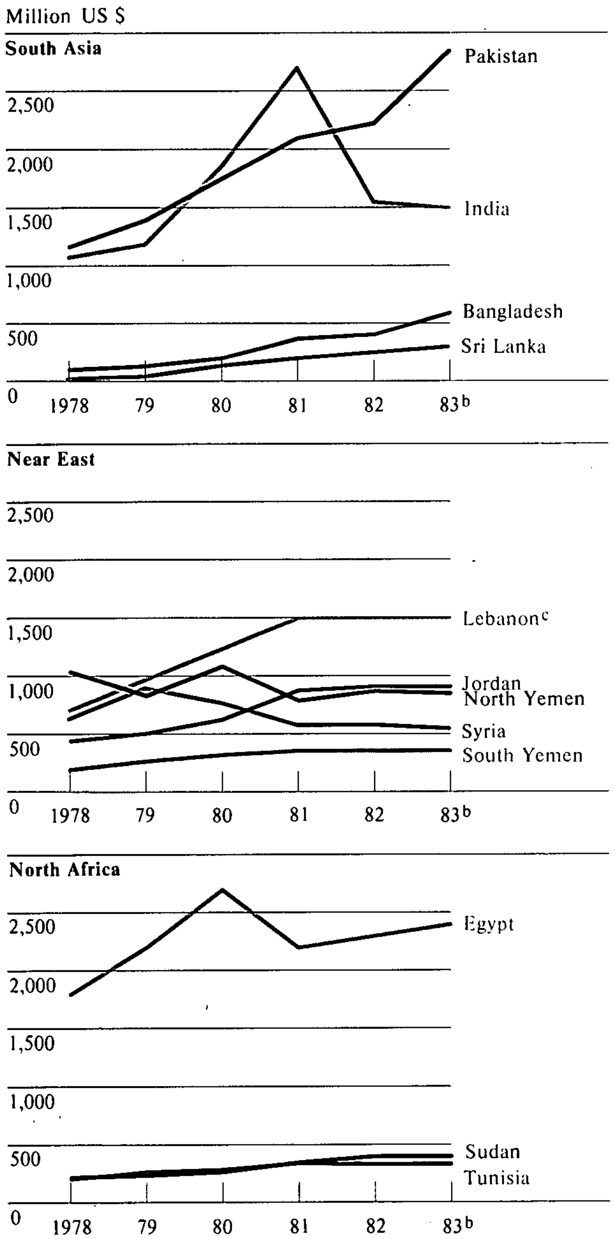
Figure 3
Official Foreign Exchange Earnings From Worker Remittances[a]



[a] Fiscal years.
[b] Projected.
[c] Includes estimate of earnings only from other Near Eastern countries; total remittances reached an estimated $3 billion in 1982.

[redacted]

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the worldwide oil surplus. Indian petroleum companies cannot afford to investigate the less promising areas that were offered to the foreign companies. Pakistan has had a similar experience in its recent attempts to stimulate greater exploration by Western oil companies. [redacted] 25X1

Foreign Trade Only Slightly Affected. We believe that the oil importers will be only marginally affected if, as we expect, reduced revenues to the oil exporters result in cutbacks in their merchandise imports. Merchandise exports from the region's oil importers to the oil exporters total only $3.5 billion, 14 percent of their total exports (table 6). Much of this is foodstuffs which are unlikely to be cut off. India stands to be a loser because construction materials and equipment for development projects make up about 30 percent of the value of its exports to the Near East. [redacted] 25X1

Even though some of the countries in the region may suffer sales declines to the oil exporters, we expect the region as a whole to be compensated by increased demand for their products in the industrialized countries as their economies are revitalized by falling oil prices. We believe, moreover, that competition from other suppliers and the ability of the nonoil exporters to produce exportable goods will be more important factors in intraregional trade than the oil exporters' ability to pay for the goods. [redacted] 25X1

Political Implications

We do not expect lower oil prices to make a major contribution to political stability among the oil-importing states. India and Pakistan in particular have had some easing of the pressure on their foreign exchange needs, but other domestic economic difficulties will prevent them from passing these gains to the general population. [redacted] 25X1

We believe that a combination of returning migrant workers, lowered remittances, and/or reduced aid payments would exacerbate the economic problems already present in many of the capital-poor and labor-surplus countries and make a larger share of the population susceptible to recruitment by forces opposing the government. Many of these countries—particularly Egypt, North Yemen, and Pakistan—would

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Table 5
Near East–South Asia: Bilateral Economic and Military Assistance Disbursements [a]

Million US $

Recipient	1981					1982				
		Donor State					Donor State			
	Total	Saudi Arabia	Kuwait	UAE	Qatar	Total	Saudi Arabia	Kuwait	UAE	Qatar
Total worldwide	**14,410**	**8,565**	**2,740**	**2,210**	**895**	**12,365**	**6,975**	**3,305**	**1,470**	**615**
Total NESA	**14,050**	**8,245**	**2,720**	**2,190**	**895**	**11,405**	**6,110**	**3,235**	**1,445**	**615**
Arab states	13,535	7,850	2,675	2,140	870	10,845	5,785	3,075	1,395	590
Bahrain	50	NEGL	50							
Iraq [b]	8,000	4,000	2,000	1,400	600	5,520	2,400	2,000	800	320
Jordan	1,175	635	210	245	85	1,200	770	205	140	85
Lebanon	445	310	65	45	25	260	40	120	75	25
Morocco	790	785	5			635	495	115	25	
North Yemen	335	330	5			335	335			
Oman	195	110	10	50	25	80	55			25
Sudan	460	370	NEGL	90		255	205		50	
Syria	1,980	1,215	320	310	135	2,225	1,205	610	285	125
Tunisia	70	70	NEGL			100	100			
Other Arab	35	25	10			235	180	25	20	10
Other NESA	515	395	45	50	25	560	325	160	50	25
Bangladesh	135	110	25	NEGL		55	55		NEGL	
Pakistan	360	275	10	50	25	430	245	110	50	25
Sri Lanka						10	10		NEGL	
India	20	10	10			65	15	50		

[a] Data rounded to nearest $5 million.
[b] Disbursements made to Iraq are carried as loans by the supplier countries.

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have limited employment opportunities for even a small fraction of the returning workers. We believe that the increase in the ranks of unemployed would increase frustration and heighten political tension, particularly in the urban areas.

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Outlook

Short Term

The presence of the world's major oil exporters ensures that the Near Eastern–South Asian region will be a net loser under a continued soft oil market scenario if only because of the absolute loss of capital flowing into the region. We expect that, at least for the next two years or so, the populations of all the major oil-exporting states, with the possible exceptions of Libya (already in economic trouble because of bureaucratic mismanagement and questionable military spending) and Iraq (in financial straits because of the war with Iran and the loss of oil production and facilities), will be sheltered from the adverse impact of the soft oil market by the surplus revenues accumulated throughout the 1970s.

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Table 6
Near Eastern and South Asian Oil Importers: Merchandise Exports, 1981

Million US $

Exporters	Total Merchandise Exports	Exports to Oil Producers
Total	**24,554**	**3,508**
Middle East and North Africa	10,899	1,643
Israel	5,140	100
Jordan	744	318
Lebanon	1,250	750
Mauritania	325	NEGL
Morocco	2,160	115
North Yemen	40	5
South Yemen	420	180
Sudan	820	175
South Asia	13,655	1,865
Afghanistan	260	5
Bangladesh	750	70
India	8,700	915
Pakistan	2,880	740
Sri Lanka	1,065	135

In our view, most of the non-OPEC capital-poor oil producers will not face severe financial hardships from the soft oil market so long as prices remain stabilized and the OPEC states refrain from retaliatory price cutting. Egypt, however, is in a particularly vulnerable position because it is dependent not only on direct oil earnings, but also on indirect oil-based revenues from worker remittances, Suez Canal tolls, and Sumed pipeline fees. We believe that a combination of reductions from several revenue sources or sharp increases in commodity import prices would leave Egypt scrambling for new sources of financial support.

On balance, we expect the oil-importing countries in the region to benefit from a soft oil market for the next two years or so. Lower oil prices will provide immediate relief on import bills. We expect India to continue to be the big short-term winner. Lower oil prices will have an immediate positive effect on its current account deficit. According to the US Embassy in Islamabad, the Pakistani balance-of-payments situation has also improved in the last six months, in part because of lower oil prices; reporting from Rabat shows that Morocco too has benefited financially. The need for foreign workers is not likely to decline appreciably over this period, although some of the Gulf states have already reported a cutback in their expatriate work force. Aid donations from the oil exporters are lagging behind last year's pace, but we do not believe there will be a dramatic cut from previous levels because of the donors' concerns for their own security if they reduce aid 25X1

Long Term

In our view, a soft oil market that persists for more than two or three years would raise the risk of political instability even in Saudi Arabia and the Gulf sheikhdoms. Although their small populations could be cared for with financial reserves and revenues from limited oil production, we believe that even the threat of austerity measures could significantly heighten discontent, particularly among the Shias. 25X1

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In the long term, diminished opportunities for foreign workers in the oil-exporting states would eliminate the major employment outlet for the rapidly growing labor forces in the capital-poor, labor-surplus countries of the region. We expect that the accompanying slowdown in the growth of remittances would adversely affect economic development, especially in Pakistan, Jordan, Egypt, and North Yemen. A sharp decline in hard currency from remittances, particularly if accompanied by a cutoff in Arab aid, would force many to adopt unpopular austerity measures such as reducing imports and cutting back development plans and to press the International Monetary Fund, Western donors, or Arab sources for additional financial support. If the governments failed to meet the economic and social expectations of returning migrants, a likely event under such a scenario, we expect that forces opposing the governments would pick up additional political support and provide opportunities for Soviet or other outside influence. 25X1

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Implications for the United States

In our view, the major concern that will face the United States if the soft oil market persists will be coping with the increased demands for financial assistance. With a reduction in worker remittances and aid from the oil-exporting states, the oil-importing nations will look increasingly to the United States and Western financial institutions for support to cover the projected growth in foreign exchange deficits. [redacted] 25X1

We believe that the United States faces a special problem with Pakistan and Egypt on financing their future military purchases and development projects. If Islamabad is not successful in soliciting additional funding for its military modernization program from the Arab oil exporters, Saudi Arabia in particular, we expect it to look to the United States for support as a test of Washington's commitment. Egypt's reduced oil revenues, along with potential losses from other sources of foreign exchange, will make Cairo even more heavily dependent on outside sources to meet foreign exchange shortages. [redacted] 25X1

We would expect cutbacks in spending by the major oil exporters to slow the growth of US merchandise and arms exports to the area and, if oil prices are lowered further, perhaps even reduce them. US civilian exports to the oil exporting states are concentrated in machinery and transportation equipment. US firms also receive a large number of service contracts. US exports to Saudi Arabia alone in 1982 were $8.5 billion. [redacted] 25X1

We believe that financial problems for both the oil-exporting and oil-importing states of the region could translate into political problems for their leaders. Under such circumstances, we would expect these governments to be even less disposed to take positions on regional issues favorable to the United States. The United States is perceived by many Arabs and Muslims as biased toward Israel and indifferent to the plight of Palestinians. We believe regional governments would be reluctant to provoke additional domestic criticism or the wrath of their neighbors by supporting policies that would associate them closely with the United States. [redacted] 25X1

Figure 4
Near East-South Asia: Effects of Soft Oil Market

	Oil Exports	Worker Remittances	Foreign Aid	Merchandise Exports	Economic Development	Oil Imports	Merchandise Imports	Net Effect
North Africa/Levant								
Algeria	⦶	O	O	O	O	O	⦶	⦶
Egypt	⦶	O	●	●	⦶	O	O	⦶
Israel	O	●	●	O	●	◐	●	O
Jordan	O	O	⦶	O	⦶	◐	O	⦶
Lebanon	O	O	O	O	O	◐	O	O
Libya	⦶	O	O	O	⦶	O	○	⦶
Mauritania	O	O	O	O	●	O	O	O
Morocco	O	O	⦶	O	O	◐	O	O
Sudan	O	O	O	●	O	O	O	O
Syria	⦶	O	⦶	O	⦶	◐	O	⦶
Tunisia	⦶	O	O	⦶	O	O	O	O
Persian Gulf								
Bahrain	O	O	O	O	O	●	O	O
Iran	O	O	O	O	O	O	O	O
Iraq	O	O	O	O	⦶	O	O	⦶
Kuwait	⦶	O	O	O	O	O	O	O
Oman	O	O	O	O	O	O	O	O
Qatar	O	O	O	O	O	O	O	O
Saudi Arabia	○	O	O	O	⦶	O	O	⦶
UAE	⦶	O	O	O	⦶	O	O	O
North Yemen	O	O	⦶	O	⦶	O	O	O
South Yemen	O	O	⦶	O	⦶	O	O	O
South Asia								
Afghanistan	O	O	O	O	O	O	O	●
Bangladesh	O	O	O	O	O	O	O	O
India	O	O	O	O	●	●	●	◐
Pakistan	O	O	O	O	O	●	O	O
Sri Lanka	O	O	O	O	O	O	O	O

Boundary representation is not necessarily authoritative.

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EFFECT OF THE SOFT OIL MARKET

● Dramatic positive ○ Dramatic negative ● No effect
◐ Moderate positive ⦶ Moderate negative O Not applicable
O Slight positive O Slight negative

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Appendix A

Effects of Soft Oil Market on Selected Countries

The Oil Exporters

OPEC

Saudi Arabia. Saudi Arabia has been the biggest loser in absolute terms. Earnings from oil have fallen from $111 billion in 1981 to $74 billion in 1982 and, based on production thus far and oil industry estimates, may decline an additional $30 billion this year. The Saudi leadership has so far taken only a piecemeal approach to dealing with the falling revenues. [redacted] some payments to foreign contractors are being delayed, several new development projects have been put on hold, and investment for oil facilities and other capital projects has been slowed. Overall spending remains close to last year's level, and, according to recent foreign trade statistics, imports are still rising. [redacted]

[redacted] the royal family continues to agonize over how much and where to implement deeper spending cuts. We believe that they are reluctant to cut the benefits and subsidies to which most Saudis have grown accustomed. [redacted] the military is committed to stepped-up purchases of equipment, and the government sees foreign aid as a necessity to protect against radical Arab action, preserve moderate Arab regimes, and prop up hard-pressed Iraq. [redacted]

Unless there is an oil price collapse, we expect the Saudis to continue to procrastinate on spending decisions while drawing on their foreign reserves. As reserves fall, however, we expect the government to become more selective in its expenditures. Because the Saudis have already completed much of their basic infrastructure plan, we believe that capital spending would receive most of the cutbacks, although foreign aid and domestic subsidies would probably also be reduced. [redacted]

Kuwait. Kuwait's oil revenues have been halved since 1980. In response, the US Embassy reports that the government has lowered subsidies on petroleum products by about $315 million, which has caused domestic retail prices of oil to triple. To reduce operating costs, the government has already trimmed non-Kuwaiti employment in the public sector and tightened new employment opportunities for expatriate laborers. We believe that the regime will seek gradually to reduce spending further by slowing its generous social programs and trimming waste. With a heavy dependence for basic services and management skills on a potentially volatile expatriate community one and a half times the size of the native population, we expect Kuwait to move slowly in reducing still-generous benefits or expelling large numbers of foreign workers even if oil prices decline further. [redacted]

We believe that Kuwait will also choose not to make substantial reductions in its foreign aid programs for political and strategic reasons unless oil prices decline sharply. To preserve Arab solidarity against Israel, we expect Kuwait to continue to place top priority on its aid payments to Jordan, Syria, and the PLO. It is also likely to give additional substantial aid to Iraq. We expect, however, that non-Arab countries seeking Kuwaiti money will find tighter Kuwaiti purse strings. Much of this non-Arab aid, which makes up only about 3 percent of all Kuwaiti aid, is disbursed in small amounts to many individual countries. Kuwait would have to make sweeping cuts to realize substantial savings. [redacted]

The United Arab Emirates and Qatar. [redacted] In the UAE, the government recently raised the price of premium gasoline by nearly one-third to about $1.13 per gallon, and, according to the

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US Embassy, cuts in other subsidies are being considered including other energy areas, health care, education, and water. Reporting from the US Embassies indicates that both governments are looking to reduce spending in areas that would affect expatriates more than nationals. With both states maintaining extravagant social welfare programs but still lacking coordinated, well-conceived development plans, we believe that a dose of austerity would help focus investment plans and reduce waste. We do not expect the UAE or Qatar to make major cuts in their foreign aid programs, although we do expect some delays in making payments. Payments are relatively small and made almost exclusively to Arab neighbors.

Iran. Even though it must accept lower prices for the oil it sells, Iran probably has been the OPEC state least directly affected by the soft market. By undercutting the prices of other OPEC members over the past year and a half, Iran has managed to increase oil production from its postrevolution low to a level sufficient to increase imports. Iraqi attacks have not slowed the flow of oil through Khark Island, Iran's most important oil export route. Nonetheless, we believe that oil revenues will fall short of financing Iran's ambitious plans for development spending this year.

Iraq. Lower prices have cut Iraq's income from reduced oil exports by about $1 billion, requiring Baghdad to make additional cuts in expenditures and to seek deferments on payments due in 1983. The US Interests Section in Baghdad reports that austerity measures prompted by lower oil revenues have compounded President Husayn's problems in maintaining popular support. Iraq also has faced physical constraints on its ability to export oil because its Persian Gulf terminals have been damaged and its pipeline through Syria closed. Its wartime spending and continued economic development for the past three years have in large part been underwritten by some $20 billion in aid from other Gulf states—$9 billion of it from Saudi Arabia.

Libya. The soft oil market has caused the most severe problems for the Libyan economy since Qadhafi took power in 1969. The pursuit of price maximization in 1981 reduced sales to a level insufficient to cover the country's imports. Some accommodation with the foreign oil companies operating in the country, price cutting, and cuts in development spending and imports have brought the government's income and expenditures into balance. We believe that the Libyan people have felt the effects of lower oil revenues more than the populations of any other oil-exporting country in the region. 25X1
Libyans remain disgruntled because of shortages of basic foodstuffs and other consumer goods. 25X1 25X1

Algeria. Algeria has already curtailed economic development and imposed tight domestic controls on imports to counter the effects of reduced oil revenues. 25X1
It has postponed some investment spending, drawn down foreign exchange reserves, and is borrowing money in the international financial market after an absence of almost four years. The current account deficit has remained manageable largely because Algiers has been successful in shifting from sales of crude oil to condensates and refined products. Algiers has been planning on gas exports to take up the financial slack in anticipation of a decline in oil exports because of declining oil reserves. The soft oil market and downward pressure on gas prices, however, have dampened some of the prospects for higher income from gas sales. 25X1

Non-OPEC

Egypt. Egypt so far has weathered the soft oil market better than might be expected, since oil revenues make up the largest single source of export earnings. Frequent price adjustments have enabled it to boost oil production. In the fourth quarter of 1982, output hit a record high of 700,000 barrels per day (b/d). 25X1

With an estimated 1.7 million migrant workers, mostly in Iraq and Saudi Arabia, Egypt has a major stake in the future of the oil industry elsewhere. Remittances last year were about $2.4 billion and second only to oil exports as an earner of hard currency. 25X1

We believe that the Egyptian economy is now edging toward a financial crisis. Egypt is already having some minor problems servicing its foreign debts, and 25X1

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we believe that oil export earnings will decline sharply this year. These difficulties could rapidly escalate to a foreign debt crisis should oil prices drop further, remittances decline, or if prices of key food imports rise sharply. [redacted]

Syria. A small net oil exporter with limited reserves, Syria has nonetheless increased earnings from oil exports primarily because it has been importing about 175,000 b/d of crude oil from Iran under generous terms since last year. After satisfying domestic demand from these imports as well as from indigenous production, Syria still exported enough crude oil and products in 1982 to increase earnings from oil. In addition to oil exports, Syria received remittances totaling about $600 million from expatriate workers, mostly in the oil-exporting countries, and $2.2 billion in aid from Saudi Arabia, Kuwait, the UAE, and Qatar. [redacted]

Tunisia. Oil production in Tunisia declined last year, less from the effects of the soft oil market than from natural depletion and shutdown of production facilities to install new equipment. Despite the slightly lowered production, the government increased the value of net oil exports by 3 percent by reshuffling exports and imports of crude and products. According to the US Embassy in Tunis, the government expects production to increase this year because new equipment has been installed and some small new deposits developed. The Embassy also believes that the government's quick reaction to oil price declines last year—a rigorous anti-inflation campaign and a reduction in planned government spending—should lead to an economic performance in 1983 no worse than in 1982 and probably somewhat better. [redacted]

Oman. By maintaining a flexible pricing policy and increasing production from recently developed oil deposits, Oman has compensated for lower oil prices. With a small population and a relatively recent onset of rapid economic growth, Oman still has relatively modest financial needs. While we expect some capital projects to be delayed or canceled, the government's budget projects expenditures this year to rise by almost 8 percent. [redacted]

Bahrain. With oil production on the wane for the past decade, Bahrain's economic fortunes are tied to the economic performances of Saudi Arabia and the other wealthy Arab states. The banking and insurance services offered by Bahrain are highly dependent on excess revenues from its neighbors. Its services for transit of merchandise to Saudi Arabia are also linked to the Saudi economy. [redacted]

25X1
25X1

Oil Importers

South Asia

25X1

India. While New Delhi leads the pack in savings on oil imports, it stands to lose from an economic slowdown in the oil-exporting states. Construction materials and equipment for development projects make up about 30 percent of the value of its exports to the Near East. We expect that sales losses will be only a small fraction of India's savings from its reduced oil import bill. Remittances from workers in the Near East, which are an important source of foreign exchange for India, are also threatened. Savings from all of India's overseas workers peaked at about $2.7 billion in FY 1981 prior to the return of workers from Iran and Iraq because of the disruptions of the war and the revolution in Iran. Although remittances have stabilized at near $1.6 billion, we expect that there may be a further drop in a year or two because the value of new contracts won by Indian firms in the Near East has begun to fall. [redacted]

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Pakistan. Lower oil prices have already had a positive effect on Islamabad's import bill, but this could be more than outweighed if worker remittances and foreign aid from the Near East are cut back. According to estimates from the US Embassy in Islamabad, remittances of about $2.8 billion, mostly from the oil-exporting states, will exceed Pakistan's export earnings in FY 1983. [redacted]

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Pakistan has received more Arab financial aid than any non-Arab state. From 1974 to 1980, Near Eastern oil exporters provided about $1.6 billion in bilateral economic assistance and nearly $1.3 billion in financing for military needs. Pakistan has been trying to procure an additional $0.8-1.5 billion for military purchases. Thus far we are aware of a current military commitment of only $550-600 million from Saudi Arabia. Most of it is being used to pay the 1982 and 1983 cash installments for F-16 fighters and other US military equipment

With 25 percent of the value of its total exports going to the oil producers, Pakistan also has a large stake in the Near Eastern–South Asian trade relationship. Because its exports comprise mostly foodstuffs and textiles, however, we do not believe that they will be substantially reduced.

Bangladesh. Foreign assistance and worker remittances are essential to keep the economy of Bangladesh afloat. Aid is nearly equal in value to total exports. In FY 1981, OPEC, Islamic institutions, and individual oil-exporting countries provided about $180 million in project assistance, about 10 percent of total aid to Bangladesh. Worker remittances, primarily from the Near East, have more than tripled to almost $600 million in the last five years.

Sri Lanka. While neither Arab nor Muslim, Colombo has nonetheless been drawn closer to the wealth of the Near East. About 70,000 workers—1 percent of its work force—are now in the oil-producing countries. Remittances from these workers have increased from less than $30 million in 1978 to $300 million this year and now rival tea exports as the country's largest source of foreign exchange.

Near East

Jordan. We believe that a leveling off or even a decline in worker remittances would have been likely even without an economic slowdown in the oil-exporting states. Amman was one of the earliest beneficiaries of the Near East oil boom. By 1980 an estimated 300,000 Jordanians—one-third of the total labor force—were working abroad. Worker remittances, which now total about $1 billion, have grown by an annual rate of nearly 60 percent since 1972. They have been a major contributor to the financing of the country's rapid economic growth over this period. 25X1

Aid from Arab donors—$1.2 billion in 1982—has been a major contributor to Jordan's financial well-being. We do not, however, see any major reductions, because Jordan is a confrontation state and a conservative monarchy. 25X1

25X1

Lebanon. Lower oil prices and the Lebanese relationship with the oil exporters have continued to foster economic development despite the unsettled political situation. The oil exporters are the recipients of 60 percent of Lebanon's exports and are likely to remain important customers despite a soft oil market because most of the sales are essential foodstuffs. The Central Bank in Lebanon estimates that one-third of the labor force—about 250,000 workers—has emigrated to the Gulf states as a result of the Lebanese civil war and is sending back approximately $1.5 billion yearly, covering over 80 percent of Lebanon's trade deficit. 25X1

25X1

While Lebanon was well down the list of Arab recipients of financial aid from the oil-exporting states, it is hoping for more funding for reconstruction. We expect the extent of this funding to depend at least partially on the financial health of the oil exporters. 25X1

25X1

Morocco. Rabat, the largest Arab oil importer, is benefiting from the soft oil market. It already is saving about $200 million annually from lower oil prices. We also expect that exports of phosphate rock and derivative products, its major exports, should increase in response to worldwide economic growth from reduced oil prices. These benefits, however, could be eliminated if Arab aid is reduced dramatically. The $600 million received by Morocco in 1982 was the largest aid donation by Arab countries to a nonconfrontation state. As a conservative government and one of the few remaining monarchies, Rabat has been a favorite aid recipient of Saudi Arabia. 25X1

Sudan. Already facing financial difficulties, Sudan is sensitive to any changes in import costs or sources of foreign exchange as a result of the soft oil market. Growing worker remittances and foreign aid have propped up Sudan financially for several years. Khartoum has also been receiving special attention from the moderate oil states who have been trying to ensure the survival of the Nimeiri government by providing aid and emergency balance-of-payments support. [redacted] 25X1

North Yemen. Sanaa has been living beyond its means for several years, and the economic slowdown in the Near East will make it more difficult for the government to find badly needed infusions of foreign exchange. Remittances from the approximately 700,000 Yemenis working in the oil states have provided the underpinning for the economy for a decade. Official net earnings from remittances reached about $1.1 billion in 1980 but recently have declined to about $900 million. Foreign aid, particularly from Saudi Arabia, has been an important contribution to government finances but is not likely to increase unless a serious emergency arises. [redacted] 25X1

South Yemen. Aden has been less affected by a soft oil market because it has been less reliant on the oil exporters than most other Arab states. Foreign jobs for surplus labor have been less important than in the North. Remittances, while an important source of foreign exchange, have not exceeded $350 million annually. Foreign aid from Arab oil producers for the most part has been cut off because of Aden's pro-Soviet political ties. [redacted] 25X1

Israel. Tel Aviv, with only nominal exports to the oil-producing states, should be positively affected by economic recovery, spurred by lower oil prices, in the industrialized countries. [redacted] 25X1

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